IN THE

Supreme Court of the United States

October Term, 1941.

No. 29

AMERICAN SURETY COMPANY OF NEW YORK,
Petitioner,

v.

THE BETHLEHEM NATIONAL BANK OF BETHLEHEM, PENNSYLVANIA, and L. M. REED, as Receiver of The Bethlehem National Bank of Bethlehem, Pennsylvania,
Respondents.

BRIEF FOR PETITIONER.

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BRIEF FOR PETITIONER.

On March 31, 1941, this Court granted petition for writ of certiorari to the United States Circuit Court of Appeals, Third Circuit.

It is not here intended to repeat the argument set forth in the brief supporting the petition for writ of certiorari but rather to present as well further points supporting subrogation to the primary debt in this case.

Because it was settled by the decision of this Court in *Merrill v. National Bank of Jacksonville,* 173 U. S., 19 S. Ct. 360, 43 L. Ed. 640 that in the special case of national banks liquidation claims are fixed, and interests of creditors vest in the estate, at date of insolvency, we have argued that an "equity" could not possibly arise after insolvency in favor of other creditors to cause the abandonment of the date-of-insolvency debt ratio and defeat petitioner's substitution to the primary debt of $135,000

as a dividend basis. Other decisions of this Court indicate, we believe, that even if the *Merrill* case principles do not alone conclude the instant case, so as altogether to exclude inquiry into other creditors' "equity", no such equity either on sound policy should be sought or can here validly be discovered. Thus we urge that the decision of the Circuit Court was error not only because inconsistent with the *Merrill* case principles but because based upon an unsound assumption of equity of other creditors, as well of course as because the decision denies to petitioner an *equal per centum* of participation even on the dividend basis substituted by the Circuit Court in reversing the District Court (See Reason 3 for Petition).

Subrogation is defined as the "substitution, ordinarily of another person in the place of a creditor, so that the person in whose favor it is exercised succeeds to the rights of the creditor in relation to the debt". *Sheldon on Subrogation,* 2nd Ed., Sec. 1. "The substitute is put in all respects in the place of the party to whose rights he is subrogated." *Ibid. Bouvier* (8th Ed., 3rd Revision, p. 3166) defines it as "the substitution of another person in place of the creditor so that the person substituted will succeed to all the rights of the creditor having reference to a debt due him."

Thus by definition petitioner ought to succeed to the right to dividends upon the primary debt of $135,000, for that admittedly was the right of the creditor. But the Circuit Court, differing with the District Court, said (R. 30) that it seemed fair that petitioner and other creditors should share on the basis of their respective actual losses, having "shared the same risk". The petitioner, we submit, did not "share the same risk" with the depositors,

for it had the right to expect the Bank to pay the Commonwealth's deposit and therefore it undertook a conditional risk only. The Commonwealth, not petitioner, was the creditor of the respondent Bank. Petitioner shared risk of insolvency, but not the risk of the same necessary effect in the event of insolvency.

That other creditors cannot complain of petitioner's substitution is brought out strongly in *Lidderdale's Executors v. Executors of Robinson*, 12 Wheaton 594, where this Court allowed full substitution to one co-endorser of a note against the insolvent estate of the other and, in dismissing the argument advanced by other creditors against such substitution, said (p. 595, 60):

> "What have the creditors of Robinson to complain of? They are only referred back to the situation in which they were relieved by the application of Smith's funds to the payment of the bill of exchange. If the bill of exchange still remained in the hands of the holder unsatisfied, his right to a priority from Robinson's Estate as to the moiety of the bill would be unquestionable, and if relieved from that state by the money of Smith, it is but right that Smith should have refunded to him that sum which they, without that payment, would certainly have been obliged to relinquish."

In the instant case the other creditors of the respondent Bank are, upon petitioner's substitution to the primary debt under the judgment of the District Court, merely "referred back to the situation in which they were relieved" by the application of petitioner's fund to the discharge of the deposit, because but for petitioner's payment the Commonwealth most certainly would have taken upon $135,000 the dividends awarded to petitioner on that basis in

the judgment here. What prejudice is it to them, then, that dividends on that sum should continue to the close of liquidation, and what right have they that the competing account should, in the unfinished course of the liquidation, fall from $135,000 to $68,588.56 by force of performance of a bond not given to them or in any wise for their benefit?

The policy noted by this Court in *Texas & Pacific Ry. v. Pottorff*, 291 U. S. 245, 54 S. Ct. 416, 78 L. Ed. 777, a case having to do with pledge of national bank assets, seems strictly pertinent and helpful toward sound decision in the instant case. There the general policy of the National Banking Act and principles of sound banking practice were held to prohibit pledge of such assets for private deposits because, as it was later referred to and expressed in *Inland Waterways Corp. v. Young*, 309 U. S. 517, 60 S. Ct. 646, (at p. 519):

> "To allow a withdrawal of assets of the bank from general availability would impair the bank's liquidity —its ability to meet unexpected demands by depositors—and thereby restrict the national banking system as a reliable instrument of national finance."

Surely that policy postulates the substitution of sureties to the primary debt, for unless such substitution is assured, and if sureties are to be confined instead to their rights in the collateral, the withdrawal of capital assets of national banks for the purpose of pledge must tend to be increased by the discouragement of suretyship as an alternative form of securing deposits of public funds. Sureties would be compelled to seek as large a fraction of actual pledge as they could possibly arrange in such transactions, in order to guard their eventual position in subrogation.

It is submitted that encouragement of the practice of meeting security demands by suretyship, a method which while it involves an operating expenditure does not tie up bank assets in creditors' hands, is the part of far sounder policy than the reverse—policy, too, that the Comptroller of the Currency ought fairly to welcome in the law of national bank operation.

Still another objection to the decision of the Circuit Court on point of sound law is that it tends to discourage the surety from discharging his bond. Since, under the Circuit Court holding, the surety would know that the debtor bank need pay dividends on the primary debt so long only as the secured creditor held it, he would quite naturally exert every effort to cause the creditor to retain its position in the estate and to postpone the day of substitution. Every form of arrangement of delay between creditor and surety would be invited to keep down the prospective irrecoverable loss of the surety and prevent the wholly fortuitous benefit extended the other depositors under the Circuit Court's decision. It would be a strange state of the law that would thus prompt delay in performance of the bond. This objection is not answered, we submit, by the observation of the Court below (R. 30) that "If the surety wants to prove for the full amount it can do so by paying promptly the amount of the obligation for which it stands as surety", because this observation cannot hold true in cases where payment of the bond amount would not make the creditor whole and because in any case the principal, not the surety, is the debtor and therefore in elementary justice ought to pay the debt. We contend that it begs the question thus to suggest that the surety can avoid the question by paying the debt.

It seems worthy of notice that at the time of the declaration of the first dividend in suit there was no authority against petitioner's position. On the contrary, the decision in *Fouts v. Maryland Casualty Co.*, 30 F. (2d) 357 (C. C. A. 4, 1929) had clearly declared the primary debt to be the proper basis for dividends to the surety and the only such basis consistent with the ratable dividend requirement of the Act. The very first decision to the contrary in the whole period following the *Merrill* case in 1898 was that of the Eighth Circuit Court in 1935 in *Ward v. First National Bank of Caruthersville*, 76 Fed. (2d) 256, followed by the decision of the Sixth Circuit Court in 1939 in *Maryland Casualty Co. v. Cox*, 104 F. (2d) 354. Were these two decisions sound we could not complain upon the circumstance that they followed in date the origin of the issue in the case at bar, but we submit that they departed from the long standing principles of the *Merrill* case, and, without repeating it here, we respectfully refer this Court to the comment of the District Court as to them (R. 18). and as to the proposition that there is no right in any depositor to expect their result (R. 16, 17). We point to the long period of the silence of the law on the question as indicating that no such right was conceived to exist, just as, we contend, none is pointed out in the decision of the Circuit Court here or in the two other Circuit Court decisions cited.

Should our contention for substitution to the primary debt be unsound in the judgment of this Court, the result of the decision below is still clearly erroneous, we submit, in that it denies to petitioner ratable participation even on the "actual payment" basis. The Circuit Court stated that in its opinion the actual payment by petitioner was

its loss in the sense that the amount of deposits was the depositors' loss and (R. 30) that "it seems fair that they should share, in partial compensation for their loss, on the same basis." Not adding "*to the same percentage extent*", this formula leaves petitioner with aggregate dividend award only of 35% to date, whereas it is admitted that the depositors have received 75% on their claims. Such a result is seriously and prejudicially unratable and in patent conflict with the Act, we contend, even if the principal basis were correct.

CONCLUSION.

It is respectfully submitted that the decision of the United States Circuit Court, Third Circuit, is erroneous and should be reversed and that the decision of the United States District Court for the Eastern District of Pennsylvania that

> "the plaintiff is entitled to participation in the liquidation of the Bank on the basis of $135,000, or the full amount of the Commonwealth's claim, save that in no event can it receive more than it has actually paid the Commonwealth."

should be sustained.

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